

December 3, 2004

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Reference Number: 04-0125

Ms. Vicky Schiantarelli, Manager
Certification Division
Office of Minority and Women's Business Enterprises
406 South Water, P.O. Box 41160
Olympia, WA 98504-1160

Dear Ms. Schiantarelli:

This is in reference to an appeal of Disadvantaged Business Enterprise (DBE) filed on behalf of Filo Foods, LLC ("Filo Foods"). We have carefully reviewed the material from the Office of Minority and Women's Business Enterprises ("OM&WBE") as well as the information provided by the firm's attorney, Ms. La Veeda Garlington-Mathews, and have concluded that the record should be developed further before the Department can make a final decision on the appeal. Accordingly, we are remanding the case to OM&WBE for further consideration.

It appears that the record is unclear with respect to matters likely to have a significant impact on the outcome of the case.

COOPERATION

According to the record, Filo Foods, was established in September, 2003 by Ms. LeeAnn Subelbia and her daughter Ms. Alaina Subelbia. Ms. LeeAnn Subelbia was the manager for HMS Host at the Seattle-Tacoma International Airport ("Airport"). HMS Host operates the Great American Bagel and Bakery ("GABB") and other franchises at the Airport. The Subelbia's sought to establish another GABB in the Airport's new Concourse A. The firm applied for DBE certification on March 9, 2004 with OM&WBE but was denied on March 22, 2004. The firm appealed this decision to OM&WBE, which was subsequently upheld on April 28, 2004.

According to OM&WBE, it attempted to perform a site visit at the firm's location at the airport, but could not since the facility had not been constructed. The firm's attorney, Ms. La Veeda Garlington-Mathews alleged in her July 27, 2004, rebuttal letter that 1) there was miscommunication as to when the DBE application needed to be filed for processing and that as a result of the pressure the Subelbias faced to get the process started, the firm's DBE application was delivered while the firm's matters were still being resolved, 2) a site visit was not required

because the firm's restaurant did not exist at the time of investigation, 3) any onsite visit could have been conducted at the offices of the firm, which at the time, was LeeAnn Subelbia's home, and 4) an on-site visit is only required if "there are such sites on which the firm is working at the time of the eligibility investigation." Ms. Garlington-Mathews further alleged that since OM&WBE knew the application was a newly founded firm which would be operating out of a facility which had not yet been built; it was premature for OM&WBE to render its denial. She stated:

. . . [A]t the time the certification review was conducted; OMWBE staff could have visited the Filo office at LeeAnn Subelbia's home to confirm that preparatory management activities were being conducted by the then current staff (the principals). OMWBE staff could have reviewed the business plan developed and submitted to potential lenders on the SBA guaranteed loan. Lastly, it would seem that the OMWBE staff, informed both by the verbal interaction between Filo and OMWBE staff and the documents submitted, would have realized that the evaluation for certification needed to be reasonably tailored to the circumstances. Given that the GABB facility was scheduled to open for operation in June 2004, we are not aware of a regulation that required that the application absolutely be processed in March, rather than gathering the necessary documentation as it developed, but still in time for certification to have been granted before the business opened in June.

Under the Regulation §26.83(c) and (k), recipients must perform a site visit to assess an applicant's firm eligibility for the DBE program, and make decisions on the firm's DBE application within 90 days of receiving all information from the applicant firm that is required to process the application. The record indicates that Filo Foods did not have a working site or location for its primary operations, yet submitted its application for DBE certification with OM&WBE before its business site was completed. OM&WBE therefore, should have conducted a site visit only when the business became operational or alternatively, returned the application to the firm as incomplete.

The Department notes that contrary to the firm's assertion in its rebuttal letter, a home site visit would not have been sufficient in this instance since this is a new business. While the owners may have experience running a similar business in the industry, it does not appear from the record that they have operated a business of their own from which OM&WBE could base its determination. Since no site visit was conducted, the Department cannot render a decision regarding this matter. The Department will however, address points raised by the firm in its rebuttal letter.

OWNERSHIP

OM&WBE determined that the Subelbias acquired the franchise through beneficial financial arrangements for less than current market value, and therefore did not meet the ownership requirements of the Regulation. According to OM&WBE's March 22, 2004 denial letter, it was unclear if the owners were acquiring a new franchise or taking over GABB since the documentation necessary to acquire a franchise was missing from the file. In its April 28, 2004 letter, OM&WBE indicated that 1) the GABB's website indicates that a franchisee must have a cash investment of \$60,000.00 to \$80,000.00 and pay a \$20,000.00 franchise fee, 2) GABB

waived the \$20,000.00 initial franchise fee, 3) there was nothing to substantiate that Alaina Subelbias contributed her own funds to obtain her interest in the firm, and 4) the firm provided documentation indicating that \$80,000.00 in funds was available, however nothing shows that Filo Foods actually spent any of that funding on the construction or start up of the business.

1. Ms. Garlington-Mathews alleged in her rebuttal letter that to capitalize the firm, LeeAnn Subelbia took out a Home Equity Loan; secured by her residence to obtain \$85,000.00 which she combined with her other personal funds. She also received a SBA guaranteed loan from ----- for ----- which was secured by Alaina's home and personally guaranteed by both women. She stated:

To qualify for this loan, the Subelbias were required; pursuant to . . . the SBA Loan Authorization . . . to inject at least ----- cash as equity capital. These funds were accumulated from the proceeds of the ----- gift from ----- the home equity secured by LeeAnn's home, and personal savings. . . . What is clear is that the terms of the SBA guaranteed loan, which required the Subelbias' to invest ----- into the project, necessitated the owners to inject more than three times the minimum investment required to obtain a GABB franchise.

According to the rebuttal letter, some of the funds used in the business were from proceeds from a gift to Alaina Subelbias from her father and a home equity line of credit secured by LeeAnn Subelbia's home. Under the Regulation, §26.69(j), it is possible that although these funds may have been a gift, they still could be counted as part of Alaina's capital contribution if ----- is a socially and economically disadvantaged individual within the meaning of the Department's Regulation. There is no indication in the record indicating whether this is the case and OM&WBE must look into this further.

2. Ms. Garlington-Mathews alleged in her rebuttal letter that the franchisor's policy was that a \$20,000.00 franchise fee is collected for the first unit at an airport, but would be waived for any subsequent franchisee, such as the one to be opened by the Subelbias. The rebuttal letter contains a copy of a letter from GABB's attorney dated July 27, 2004, which states:

It came to our attention that Filo Franchisee provided a \$20,000.00 check for the payment of an initial franchise fee pursuant to Section IV.A of the franchise agreement. In the final form of the Franchise agreement executed by [GABB] returned the check to your client. It has been [GABB's] policy that once an initial franchise fee is paid for the first GABB store located within an airport, no fee is collected for any subsequent GABB store that opens at that same airport. This policy applies whether the subsequent GABB store at the given airport is owned and operated by the first franchisee who shall have paid the initial franchise fee for that airport, or another unrelated franchisee. At the time [Filo Foods] entered into the franchise agreement, HMS Host was already operating two other GABB stores at Seatac Airport. . . . Since an initial franchise fee had already been collected from HMS Host for the first GABB . . . no initial franchise fee was collected either for the second GABB, nor for [Filo Foods'] GABB.

This seems to sufficiently address OM&WBE's concerns.

3. Lastly, Ms. Garlington-Mathews stated:

The April denial letter contended that while more than \$80,000 in cash funds were available, nothing in the file documented that the firm had actually spent any of the funding on the construction or startup of the business. The presumption was that the costs were being paid by some entity other than Filo Foods. As mentioned previously, construction actually began in March. At the time of the DBE certification denial in March, construction had barely begun. No construction draw had even been requested by the contractor, Puget Sound Builders NW under its contract with Filo. The first construction draw for the improvements in ----- for the GAB were not received for processing until April 20, 2004, and not paid until Filo's loan closed on May 10, 2004. . . . [T]he following invoices . . . document the dates, vendors, purpose of expenditure and amounts paid for many of the various elements of the construction of the GABB facility for Filo:

Vendor Purpose Amount

02/17/04	PSE permit.....	\$	-----
03/03/04	HMS Host reimburse architectural fees.....	\$	----- 7
03/26/04	P&R signs	\$	-----
03/26/04	Centre Pointe Exhibits signs	\$	-----
04/02/04	HMS Host reimburse food court common area seating cost	\$	-----
04/08/04	HMS Host postage for appeal letter	\$	-----
05/28/04	Puget Sound Builders NW First construction draw.....	\$	-----

The first construction draw was received on April 20, 2003, and paid when the loan closed on May 10, [2004]. Clearly most of these expenditures were billed and paid after DBE certification had already been denied in March 2004. However, what these invoices and checks also confirm is that they were paid by Filo Foods. As discussed previously, some expenditures such as the architect fees and construction of the common area seating outside the GABB facility were supposed to be paid initially by Host, and then recouped via reimbursement. This arrangement was not peculiar to Filo Foods; it was used for other DBE subtenants on the same concourse. Since the first draw was not even received until late April, clearly there would have been no documentation of construction payments at the time the DBE certification was denied. These are but a few of the invoices related to the construction of Filo's deli.

In upholding its appeal denial, OM&WBE referenced the contract between Puget Sound Builders NW and HMS Host for the GABB site and determined that there was no indication that the firm paid for any construction costs. As indicated above, expenditures were billed to Filo Foods which the firm may have paid. The firm's appeal letter contains copies of invoices from HMS Host to Filo Foods and copies of checks the firm remitted for design and contractor costs. It therefore appears that HMS Host was involved in the initial construction of the site but that Filo Foods was to reimburse HMS Host for this cost. Section 10 of the sublease between Filo Foods and HMS Host dated March 19, 2004 indicates that the firm is required to: "pay HMS Host for the projected total cost of any and all design and development expenses incurred by HMS Host

with respect to the premises, plus [HMS Host's] pro rata food court searing costs for the projected total cost of ay and all design, development and construction expenses incurred by Host. . . ." OM&WBE needs to determine whether this is a common arrangement among concessionaires waiting for their site to be built. Since these issues are relevant to the Subelbias' contribution to acquire their ownership in Filo Foods, the Department is remanding this matter back to OM&WBE.

CONTROL

OM&WBE determined that 1) both LeeAnn Subelbia and Alaina Subelbia were absentee owners at the time of their DBE application; and 2) the firm was dependent upon HMS Host, a non-disadvantaged business.

1. According to the firm's DBE application, both owners indicated that they work for HMS Host but would terminate their employment prior to opening the business. OM&WBE acknowledged in its certification denial letter that LeeAnn Subelbia submitted a letter of resignation but that she planned to continue working for HMS Host until April 30, 2004. Ms. Garlington-Mathews alleged in the firm's rebuttal letter that 1) it was made clear to OM&WBE that the Subelbias' would be terminating their employment with HMS Host on April 30, 2004 before opening their GABB franchise; and 2) since the site at the airport was still under construction, the owners continued working for HMS Host and could handle the affairs of the firm around their scheduled duty hours.

Under the Regulation, §26.71(j) disadvantaged owners are not deemed to control a firm if they engage in outside employment or other business interests that prevent them from devoting sufficient time and attention to the affairs of the firm. In this instance however, the firm's business was under construction and it seems reasonable that the Subelbias would continue working at HMS Host since the firm's site was not yet built.

2. According to the record, Filo Foods does not appear to have submitted a franchise agreement with HMS Host at the time of its DBE application, but rather submitted an Assignment of Franchise Agreement dated February 19, 2004. This agreement transfers LeeAnn Subelbia's interest to Filo Foods for \$10.00. As mentioned above, OM&WBE reviewed the contract between Puget Sound Builders NW to a representative of HMS Host regarding the GABB at the Airport. According to OM&WBE, the project cost of ----- .56 was identical to the amount specified in the February 23, 2004, contract between Puget Sound and Filo Foods. Also, OM&WBE determined that the firm's schedule of work and purchase orders were submitted with its appeal. Lastly, OM&WBE indicated that the firm did not provide documentation indicating that the Port had accepted the firm as a subleasee, which is a necessary condition in the sublease between Filo Foods and the Port of Seattle. The sublease states:

This sublease is subject to and contingent upon the Port's written acceptance of Concessionaire as a subtenant under the lease. If the foregoing condition has not been satisfied by April 20, 2004, this sublease shall be null and void and in such event, concessionaire agrees to hold Host harmless and shall not in any way pursue any claim against Host.

According to OM&WBE, all the purchase order numbers reference GABB/HMS Host with no reference to Filo Foods. OM&WBE therefore, determined that 1) HMS Host and Filo Foods had

an affiliation since HMS Host would continue to operate the franchise through May 31, 2004, with LeAnn Subelbia in some type of management capacity; and 2) Filo Foods was dependent upon HMS Host's proposal with Puget Sound Builders for its construction contract.

Ms. Garlington-Mathews alleged in her rebuttal letter, that at the time of OM&WBE's March, 2004 certification denial, Filo Foods was still in the process of finalizing the Franchise Agreement and its SBA loan was still being evaluated for funding. Because the loan closed on May 10, 2004, she alleged that the absence of documentation regarding payment of construction of the site led OM&WBE to conclude that the project was funded by an entity other than Filo Foods and that the firm was closely intertwined with HMS Host.

In essence, OM&WBE rendered its conclusions because the firm's site had not been constructed. As the firm's rebuttal letter indicates, various factors exist that may explain the nature of the firm's relationship with HMS Host. We request that OM&WBE revisit its determination with these factors in mind.

We specifically request that a new decision be issued within forty-five (45) days with further consideration being applied to the above areas of concern. To obtain the specific information noted above, an on-site review is required since OM&WBE was unable to conduct one previously. We suggest that if all possible, OM&WBE afford Filo Foods an opportunity to adequately rebut and present evidence. However, if you still conclude that the firm does not meet the eligibility requirements of the Regulation, Filo Foods will, of course, have the opportunity to renew its appeal to this office. This appeal is being closed in our files pending outcome of this remand.

Sincerely,

Joseph E. Austin, Chief
External Policy and Program Development Division
Departmental Office of Civil Rights

cc: La Veeda Garlington-Mathews